



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Release Number: **201419017**
Release Date: 5/9/2014
Date: February 10, 2014
Uniform Issue List:
4942.00-00
4942.03-03

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Legend:

<u>LLC</u>	=
<u>Grantor</u>	=
<u>Trust</u>	=
<u>C</u>	=
<u>X</u>	=
<u>Y</u>	=
<u>Z</u>	=
<u>D</u>	=

Dear :

This letter is in response to the May 23, 2012, letter from your authorized representative, requesting a ruling on the proper treatment of certain undeveloped real estate for purposes of determining your minimum investment return under I.R.C. § 4942.

Facts:

You have been recognized as exempt under § 501(a) as an organization described in § 501(c)(3). You are a private foundation described in § 509(a). You were formed by Trust, which was formed by Grantor. You are authorized to make distributions to such charitable organizations recognized as exempt under § 501(c)(3) as you determine. Pursuant to this authorization, you have made distributions to various public charities, including, but not limited to, C, a government instrumentality of a political subdivision.

LLC is a limited liability company wholly owned by you as its sole member and is a disregarded entity for purposes of federal income taxation. You made a distribution to LLC in the form of a park built by you. This park land and the associated park improvements were conveyed to C by means of a deed of dedication, which is recorded in the public land records.

You currently hold approximately \$x in cash and securities, and approximately y acres in undeveloped real estate. You hold title to the undeveloped real estate in the name of LLC. Of the approximately y acres of land owned by the LLC, you are under a legal obligation, pursuant

to a zoning condition, in addition to an express written agreement with C, to dedicate approximately z acres to C at a future date following expiration of a life estate in favor of D contained within the z acre parcel. This parcel will also contain a site that is the final resting place of Grantor and his wife, together with historical marker, tombstone, and associated graveside improvements. The remainder of the undeveloped real estate is held for investment.

You state that all of the economic value of the undeveloped land you own through the LLC derives from development rights approved by the locality and located on the y acres. The portion of land that is held for investment, which you refer to as the "development site," has been appraised by a qualified independent appraiser. The balance of the land generates no income, and it has no economic value. This is because it either is subject to future dedication to C, has been constructed as streets, sidewalks, or other common areas encumbered by a public use and access easement, or is the site of the graves of Grantor and his wife.

You state that the development site has declined in value due to the economic downturn that began in 2008. You plan to hold the development site indefinitely, but will eventually sell it when economic conditions are more favorable. Given present economic conditions, you anticipate holding the development site for several more years. The development site produces no income and, as noted, has significantly depreciated in market value since 2008. The development site has been appraised by means of a certified, independent appraisal made in writing by a qualified person who is neither a disqualified person with respect to, nor an employee of, you. The appraisal contains a statement that, in the opinion of the appraiser, the values placed on the assets appraised were determined in accordance with valuation principles regularly employed in making appraisals of such property using all reasonable valuation methods. You have retained a copy of the independent appraisal for your records. You are presently relying upon this appraisal in determining the fair market value of your land holdings for tax reporting purposes.

In the past, you have allowed C to cut hay on the land. You have now entered into a written lease with C, whereby C will cut hay on the development site and use this hay to feed livestock at a historical working farm park located at a facility owned and operated by C. The amount paid by C under the lease will not exceed \$1 per year. Under the lease, C will own any hay it cuts on the development site, and you will not count any such hay as a distribution under § 4942. This lease will benefit C, as there is no other hay available within a reasonable distance from the facility. You will renew the lease annually for so long as C wishes to harvest hay from the development site or until such time as you decide to market the development site for sale, whichever occurs first.

Ruling Requested:

The land comprising the development site, when under lease to C at a nominal or no cost, may be excluded from the aggregate fair market value of all of your assets used in computing the minimum investment return under § 4942(e)(1).

Law:

I.R.C. §§ 501(a) and 501(c)(3) provide exemption from federal income tax for organizations that are organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

I.R.C. § 4942(a) imposes a tax of 30 percent on the undistributed income of a private foundation for any taxable year, which has not been distributed before the first day of the second (or any succeeding) taxable year following such taxable year.

I.R.C. § 4942(c) provides that, for purposes of § 4942, the term "undistributed income" means, with respect to any private foundation for any taxable year as of any time, the amount by which the distributable amount for such taxable year, exceeds the qualifying distributions made before such time out of such distributable amount.

I.R.C. § 4942(d) provides that, for purposes of § 4942, the term "distributable amount" means, with respect to any foundation for any taxable year, an amount equal to (1) the sum of the minimum investment return plus the amounts described in subsection (f)(2)(C), reduced by (2) the sum of the taxes imposed on such private foundation for the taxable year under Subtitle A and § 4940.

I.R.C. § 4942(e)(1) provides that, in general, for purposes of § 4942(d), the minimum investment return for any private foundation for any taxable year is 5 percent of the excess of (A) the aggregate fair market value of all assets of the foundation other than those which are used (or held for use) directly in carrying out the foundation's exempt purpose, over (B) the acquisition indebtedness with respect to such assets (determined under § 514(c)(1) without regard to the taxable year in which the indebtedness was incurred).

Treas. Reg. § 53.4942(a)-2(c)(3)(ii)(f) provides an illustration of assets which are "used (or held for use) directly in carrying out the foundation's exempt purpose." One example is any property leased by a foundation in carrying out its charitable, educational, or other similar exempt purpose at no cost (or at a nominal rent) to the lessee or for a program-related purpose (within the meaning of § 4944(c)), such as the leasing of renovated apartments to low-income tenants at a low rental as part of the lessor foundation's program for rehabilitating a blighted portion of a community.

Treas. Reg. § 53.4942(a)-2(c)(4)(iv)(b) provides, in part, that if its requirements are met, the fair market value of any interest in real property, including any improvements thereon, may be determined on a 5-year basis. Such value must be determined by means of a certified, independent appraisal made in writing by a qualified person who is neither a disqualified person with respect to, nor an employee of, the private foundation. The appraisal is certified only if it contains a statement at the end thereof to the effect that, in the opinion of the appraiser, the values placed on the assets appraised were determined in accordance with valuation principles regularly employed in making appraisals of such property using all reasonable valuation methods. The foundation shall retain a copy of the independent appraisal for its records. If a

valuation made pursuant to the provisions of this subdivision in fact falls within the range of reasonable values for the appraised property, such valuation may be used by the foundation for the taxable year for which the valuation is made and for each of the succeeding 4 taxable years. Any valuation made pursuant to the provisions of this subdivision may be replaced during the 5-year period by a subsequent 5-year valuation made in accordance with the rules set forth in this subdivision, or with an annual valuation made in accordance with subdivision (iv)(a) of this subparagraph, and the most recent such valuation of such assets shall be used in computing the foundation's minimum investment return.

Rev. Rul. 71-529, 1971-2 C.B. 234, holds that an organization that is performing an essential function for charitable organizations for a charge that is substantially below cost is performing a charitable activity within the meaning of § 501(c)(3).

Rev. Rul. 75-207, 1975-1 C.B.A 361, describes an organization formed to further conservation, education, and the arts, which owns and maintains an uninhabited island (except for a small professional staff) off the coast of the United States. The organization is dedicated to the preservation of the island in its present state. To do that, it restricts general public access. The organization's researchers are invited to the island, and their findings are published and disseminated to the general public. The revenue ruling holds that the island is being used directly to carry out the organization's exempt purposes in the manner indicated in § 53.4942(a)-2(c)(3), and that the organization may exclude the value of the island in computing its minimum investment return under § 4942(e).

Analysis:

Generally, § 4942(a) imposes an excise tax on any private foundation that fails to satisfy the minimum distribution requirement. In order to determine the amount a private foundation must distribute to avoid the excise tax under § 4942(a), it is necessary for a private foundation to determine its minimum investment return. A private foundation's minimum investment return, generally, is five percent of its net assets, with the exception of assets it uses directly to carry out its exempt purpose(s). Whether a private foundation uses an asset for its exempt purpose(s) is a question of fact.

For purposes of § 4942(e), the term "minimum investment return" takes into account the aggregate fair market value of all assets of a foundation other than those which are used (or held for use) directly in carrying out the foundation's exempt purpose.

Your principal charitable purpose is to make distributions to such charitable organizations as you determine. You currently hold approximately \$x in cash and securities, and approximately y acres in undeveloped real estate. You state that the larger part of this land, the development site, generates no income. Given the current economic conditions, you anticipate holding the site for several more years. The development site has been appraised by means of a certified, independent appraisal made in writing by a qualified person who is neither a disqualified person with respect to, nor an employee of, you. The appraisal is certified because it contains a statement at the end thereof to the effect that, in the opinion of the appraiser, the values placed on the assets appraised were determined in accordance with valuation principles regularly employed in making appraisals of such property using all reasonable valuation methods. You

have retained a copy of the independent appraisal for your records. You are presently relying upon this appraisal in determining the fair market value of your land holdings for tax reporting purposes. This meets the approval guidelines set forth in § 53.4942(a)-2(c)(4)(iv)(b) for the development site.

You have allowed C to cut hay on the development site in the past, and you have now entered into a written lease with C, whereby C will cut hay on the development site and use this hay to feed livestock at its historical working farm park located at a facility owned and operated by C. The amount paid by C under the lease will not exceed \$1 annually. C will own any hay it cuts under the lease, and you will not count any such hay as a distribution under § 4942. This lease will benefit C, you state, because there is no other hay available to C within a reasonable distance from its facility. This is similar to the situation presented in Rev. Rul. 75-207. In that ruling, we determined that a private foundation's ownership and maintenance of an island, dedicated to preserve the natural ecosystems and historical and archaeological remains on the island, that has no residential use, and to which present access is limited to invited public and private researchers, may be excluded from the foundation's minimum investment return under § 4942(e). The ruling stated that limiting access to the island was uniquely essential to the fulfillment of the foundation's educational and charitable purpose, and thus, the island was found to be used directly in carrying out the foundation's exempt purposes. See also Rev. Rul. 71-529 (where we held that a nonprofit organization that provides assistance in the management of participating colleges' and universities' endowment or investment funds for a charge substantially below cost qualifies for exemption under § 501(c)(3)).

Your leasing activity is consistent with the situations presented in the revenue rulings described above. You will renew the lease annually for so long as C wishes to harvest hay from the development site or until such time as you decide to market the development site for sale, whichever occurs first. Since your charitable purpose is to support other charitable organizations, leasing the development site to C to permit C to grow and harvest hay will be use for an exempt purpose, in the same manner as the situation described in § 53.4942(a)-2(c)(3)(ii)(f).

Ruling:

The land comprising the development site, when under lease to C at a nominal or no cost, may be excluded from the aggregate fair market value of all of your assets used in computing your minimum investment return under § 4942(e)(1).

This ruling will be made available for public inspection under § 6110 after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling, with deletions, that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, contact the person whose name and telephone number are shown in the heading of this letter.

We are sending a copy of this letter to your other co-trustee.

Enclosure:
Notice 437

Sincerely yours,

Ronald J. Shoemaker
Manager, Exempt Organizations
Technical Group 2